IN THE

Supreme Court of the United States

October Term, 1945

No. 384

FORREST S. SMITH, Trustee of the Property of Hoboken Manufacturers Railroad Company, Debtor; The Debtor, HOBOKEN MANUFACTURERS RAILROAD COMPANY; and SEATRAIN LINES, INC., a Creditor,

Petitioners,

vs.

HOBOKEN RAILROAD, WAREHOUSE AND STEAMSHIP CONNECTING COMPANY; and HOBOKEN LAND AND IMPROVEMENT COMPANY,

Respondents.

BRIEF FOR THE DEBTOR, HOBOKEN MANUFACTURERS RAILROAD COMPANY, AND SEATRAIN LINES, INC., PETITIONERS.

PARKER McCOLLESTER,
25 Broadway,
New York 4, N. Y.,

EDWARD A. MARKLEY,
1 Exchange Place,
Jersey City 3, N. J.,

Attorneys for Hoboken Manufacturers Railroad Company, Debtor, and Seatrain Lines, Inc., Petitioners.

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BRIEF FOR THE DEBTOR, HOBOKEN MANUFACTURERS RAILROAD COMPANY, AND SEATRAIN LINES, INC., PETITIONERS.

Opinions Below.

The opinion of the District Court of the United States for the District of New Jersey, filed August 4, 1944, is reported in 56 F. Supp. 187. It is printed in the transcript of the record herein at page 42 and again at page 80.

The opinion of the Circuit Court of Appeals for the Third Circuit, filed July 17, 1945, has not yet been printed in the official reports. It is reproduced in the transcript of the record herein beginning at page 94.

qualification of the Trustee and his entry into the possession of the properties of the railroad under the direction of the court constituted a breach of the covenant of the main stem lease against transfer, entitling the lessor Connecting Company to terminate the lease and retake the leased property. In concluding his opinion, he ruled:

> "The motion to terminate the lease is granted to take effect upon production to the court of conclusive evidence that the requirements of the laws relating to the continuous operation of the railroad have been complied with." (R. 45).

The language quoted had reference to a question which had been raised during the course of the proceedings as to whether the lessor Connecting Company could lawfully reacquire and operate the leased properties without having secured a certificate of convenience and necessity from the Interstate Commerce Commission, pursuant to Section 1 (18)-(20) of the Interstate Commerce Act, the Court evidently being convinced that the public interest required the continued operation of the railroad.

Following this opinion, appellee Land Company filed a petition for an order terminating the leases of plots A and B by reason of the tie-in agreement, and the return of these parcels to it (R. 46-49).

The lessor Connecting Company then presented to the Interstate Commerce Commission a petition for the issuance to it under Section 1 (18)-(20) of the Interstate Commerce Act of a certificate of convenience and necessity authorizing it to acquire and operate the property covered by the main-stem lease as a railroad in interstate commerce, submitting with this petition a motion to dismiss the petition on the ground that such a certificate was not required by the sections of the Interstate Commerce Act referred to. The Commission, without holding a hearing

for the receipt of evidence, dismissed the petition, ruling that the Connecting Company as the owner could lawfully operate the properties as a railroad without holding a certificate from the Commission. The Commission based its ruling upon the ground that the Connecting Company as the owner in fee of the main stem must be under a franchise obligation to maintain and operate the railroad, that the debtor-lessee Hoboken, as lessee of the railroad, operated it as agent for the lessor, and consequently that the lessor might be deemed to have been in operation through the agency of the debtor-lessee in 1920, when the provisions of Section 1 (18)-(20) were enacted. The Commission passed over the fact that the Connecting Company was not the owner of plots A and B and that there were other parcels comprising the railroad which were owned in fee by the debtor-lessee, and rejected the contention that there was a question whether the public interest could be served by the operation by the Connecting Company only of the properties of which it was the owner (R. 50-58).

It said:

> "We are not convinced that it is our duty herein to consider what practical effect the termination of the lease will have upon the operation of the properties, and in view of our conclusions it would be inappropriate for us to do so" (R. 57).

Following this decision of the Commission, the District Court on December 19, 1944 entered its Order No. 39, which is the order appealed from (R. 58-62).

By this order the District Court directed the Trustee to deliver to the lessor Connecting Company not only the main stem covered by the lease from the Connecting Company, but also plots A and B, held under leases from the Hoboken Land and Improvement Company, and all other

> "property of the debtor in the possession or under the control of the trustee and presently held or used for railroad purposes, whether real, personal or mixed, excepting money in bank, cash on hand, accounts receivable, choses in action or other intangible claims and the evidences thereof; * * *" (R. 59).

Thus the property which the Trustee was directed to deliver included not only the leased property but also property owned in fee by the debtor-lessee and property as to which title was in dispute.

From this order the Trustee, the debtor-lessee and Seatrain Lines appealed to the Circuit Court of Appeals for the Third Circuit (R. 62). That court, by an opinion filed July 17, 1945, affirmed the order (R. 94-96).

While Judge FAKE had held that the covenant against transfer of the lease had been breached by the qualification of the Trustee, the Circuit Court of Appeals held "that the lease was breached when it was adopted by the Trustee" (R. 96). The court rejected appellants' contention that the order allowing termination of the lease was premature because there had been no consideration of a plan of reorganization. The grounds of this portion of the opinion are not clear, but it appears that the court considered that the requirement of Section 77 for the filing of a plan of reorganization could be disregarded. The court's holding seems to rest upon the following statement, which is incorrect and contrary to the decision of the District Court approving the petition in reorganization:

> "It appears that the Section 77 petition was filed by the debtor because it desired to procure a lease of the railroad on more favorable terms."

Finally, the Circuit Court of Appeals upheld the portion of the order directing the Trustee to transfer to the Connecting Company not only the property covered by the

leases but also property owned by the debtor-lessee or property as to which title was in dispute. It did so on the ground that such property was small and that the order requiring such transfer "is a wise one for it permits the operation of this small trackage as a part of the main stem of the railroad". (R. 97).

It is the interest of the debtor-lessee to oppose the transfer ordered by the court because Section 77 places upon the debtor the burden and responsibility of presenting a plan of reorganization and because the property which the court below would cause the Trustee to transfer constitutes its railroad, which it seeks to continue to operate when reorganization can be effected. Seatrain's interest in opposing the order arises from the fact that it is a large creditor of the debtor-lessee and also owns all of the stock of the latter, whose value, obviously, is contingent upon its ability to continue to operate as a railroad in interstate commerce.

Specification of Assigned Errors To Be Argued.

1. The District Court erred in entering its Order No. 39 and the Circuit Court of Appeals erred in affirming that order.

2. The District Court erred in holding that the qualification of the Trustee, appointed by the court in a proceeding for the reorganization of debtor-lessee under Section 77 of the Bankruptcy Act for the purpose of conserving the railroad property and making possible the continued operation of the railroad, constituted a breach of the covenant in the lease against transfer entitling the lessor to enforce forfeiture and thereby frustrate the reorganization.

3. The Circuit Court of Appeals erred in holding that the adoption of the lease by the Trustee for the purpose of keeping the property together for continued operation and

the effectuation of a plan of reorganization constituted a breach of the covenant of the lease entitling the lessor to enforce forfeiture and frustrate the reorganization.

4. The courts below erred in failing to hold that if the qualification of the Trustee or the adoption of the lease constituted an unauthorized transfer within the language of the covenant of the lease as strictly construed, the covenant was contrary to the policy of Section 77 and could not be enforced in a proceeding for a reorganization thereunder.

5. The courts below erred in failing to give effect to the language and purpose of Section 77 to preserve railroad properties and provide for their continued operation.

6. The courts below erred in failing to hold that in advance of a plan of reorganization and without the approval of the Interstate Commerce Commission the railroad properties of the debtor-lessee could not lawfully be transferred.

7. The courts below erred in holding that all of the railroad properties of the debtor-lessee should be delivered to the lessor in the absence of authority from the Interstate Commerce Commission for the debtor-lessee and the Trustee to abandon and discontinue operations of its railroad and authority for the lessor to acquire and operate the railroad property.

8. The courts below erred in holding that all of the railroad property of the debtor-lessee, including property held under lease from the Hoboken Land and Improvement Company and property owned by the debtor-lessee as to which there were undetermined claims, should be transferred and delivered to the Connecting Company.

Summary of Argument.

I. Even if the language of the covenant of the lease were to be construed as providing for forfeiture of the lease and return of the property to the lessor upon resort by the debtor-lessee to the reorganization procedure afforded by Section 77 of the Bankruptcy Act, the covenant would be unenforceable as contrary to the Act and the public policy that the railroad shall be kept together for continued operation and its reorganization submitted to the Interstate Commerce Commission.

Section 77, unlike other provisions of the Bankruptcy Act, has for a primary purpose the protection of the public interest in the continued operation of railroads as distinguished from the interest of creditors and stockholders. To this end, it is the purpose of the Act that railroad property shall be held together for operation pending completion of a plan of reorganization; that the plan of reorganization shall be considered by the Interstate Commerce Commission; and that no property shall be abandoned or transferred pending reorganization of the operating company without the approval of the Commission. *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448; *Palmer* v. *Massachusetts*, 308 U. S. 79; *Continental Bank* v. *Rock Island Ry.*, 294 U. S. 648; *Van Schaick* v. *McCarthy*, 116 F. (2d) 987; *In re Central of Georgia Ry. Co.*, 48 F. Supp. 445; *Collier on Bankruptcy*, (14th Ed.), Vol. 5, p. 468.

With a large part of the railroad mileage of the country operated under lease, the public purpose of Section 77 would be defeated pending reorganization if a lessor could demand forfeiture of a lease on the ground that resort to the reorganization proceedings violated a covenant against transfer.

Even if there was an unauthorized transfer within the language of the lease, the covenant is unenforceable be-

cause contrary to Section 77 and the public policy evidenced thereby. *Louisville & Nashville R. R.* v. *Mottley*, 219 U. S. 467.

II. Neither the filing of the petition for reorganization, the qualification of the Trustee nor the Trustee's adoption of the lease constituted a breach of the covenant against transfer.

A provision for forfeiture of a lease is to be narrowly construed against the lessor. *Gazlay* v. *Williams*, 210 U. S. 41; *Collier on Bankruptcy* (14th Ed.), Vol. 4, pp. 1240, 1241.

The covenant in the lease here involved as so construed was not violated by the qualification of the Trustee or by his adoption of the lease for the preservation of the properties of the debtor pending reorganization. There was no express reference in the covenant to bankruptcy or reorganization. There was no unauthorized transfer because what was done was authorized by the statute. There was no sale or transfer within the intent of the covenant because the covenant was plainly aimed at transfers which would eliminate the original lessee, whereas the whole purpose of the proceeding here is to fulfill the lessor's obligations out of the lessee's assets and preserve the lease for continuance by the lessee after reorganization.

A trustee in reorganization under Section 77 does not hold a debtor's property for the purpose of liquidation. Under Section 77 and the Interstate Commerce Act railroad property may not be disposed of by a trustee except with the approval of the Commission or pursuant to a plan of reorganization approved by the Commission.

If the lessee should be reorganized pursuant to voluntary agreement of its creditors and stockholders, there would be no transfer in violation of the covenant and the

fact that the reorganization is conducted under the procedure provided by Section 77 does not alter the situation.

III. In advance of a plan of reorganization, the attempted cancellation of the lease and the courts' orders permitting such cancellation were premature.

The qualification of the Trustee did not entitle the lessor to cancel the lease because all rights under the contract were held in suspense by Section 77 and the reorganization proceeding thereunder.

Section 77 provides that a plan of reorganization may adopt or reject executory leases and allows a reasonable time for the formation of the plan. Meanwhile, the provisions of a lease and any rights of the lessor thereunder are held in suspense and forfeiture of the lease cannot be claimed on the ground of alleged violation of its provisions. *Warren* v. *Palmer*, 310 U. S. 132; *Palmer* v. *Palmer*, 104 F. (2d) 161; cert. den. 308 U. S. 590; *Continental Bank* v. *Rock Island Ry.*, 294 U. S. 648.

The adoption of the lease by the Trustee was simply for the purpose of preserving the property for effectuation of a plan of reorganization and, therefore, did not alter the fact that rights under the lease were held in suspense until the lease should be adopted or rejected in the plan of reorganization. Any other view would mean that the District Court's order directing the Trustee to adopt the lease for the purpose of preserving the property pending the plan of reorganization defeated the purpose for which the order was made.

IV. The order of the District Court permitting the lessor Connecting Company to cancel the main stem lease and directing the Trustee to convey to the Connecting Company not only the property covered by that lease but also all other railroad property used or operated by the debtor-lessee violated Section 77 of the Bankruptcy Act and Sec-

tion 1(18) of the Interstate Commerce Act and was contrary to the condition imposed by the court in its opinion.

The Trustee could not lawfully transfer the property and abandon operation of the railroad in the absence of a certificate of convenience and necessity from the Interstate Commerce Commission authorizing it to do so.

The requirement that a certificate authorizing abandonment be secured applies to discontinuance of operations by a lessee on termination of a lease. *Warren* v. *Palmer*, 310 U. S. 132; *Palmer* v. *Massachusetts*, 308 U. S. 79; *Lehigh Valley R. Co., Abandonment of Operation*, 202 I. C. C. 259.

The lessor Connecting Company may not lawfully acquire and operate as a railroad the properties to be conveyed to it pursuant to the District Court's order since it has not secured a certificate of convenience and necessity from the Interstate Commerce Commission authorizing it to do so.

The decision of the Commission that the Connecting Company was not required to obtain a certificate before reacquiring and operating the property was in error and did not excuse the court's Order No. 39. The Connecting Company was not a common carrier by railroad, operating as such, when Section 1 (18) of the Interstate Commerce Act was enacted. Therefore, it may not acquire and operate railroad property without obtaining a certificate. The Commission's theory that the Connecting Company was operating through the agency of the debtor-lessee was erroneous, disregarded the separate estate of the debtor-lessee, and was inconsistent with the decisions requiring a lessee to obtain a certificate before beginning or abandoning operation. *Transit Commission* v. *United States*, 289 U. S. 121; *Livestock Terminal Service Co., Abandonment*, 257 I. C. C. 1.

The Commission's decision that the Connecting Company is not obligated to obtain a certificate because it is

under a franchise obligation to operate its property is inconsistent with the decisions holding that state contracts or franchises do not prevail over the requirements of Section 1 (18)-(20) of the Interstate Commerce Act. *Transit Commission* v. *United States*, 289 U. S. 121; *Texas &c. R. R.* v. *Northside Ry.*, 276 U. S. 475; *R. R. Comm.* v. *Southern Pac. Co.*, 264 U. S. 331.

In any event the Commission's theory has no application here because it does not extend to plots A and B and property owned by the debtor-lessee which are not owned by the Connecting Company and, so far as appears from the record, have never been operated by it.

V. Order No. 39 should be reversed because it transfers to the lessor possession of certain railroad property owned by the debtor-lessee before determination of conflicting claims thereto.

ARGUMENT.

POINT I.

Even if the language of the covenant of the lease were to be construed as providing for forfeiture of the lease and return of the property to the lessor upon resort by the debtor-lessee to the reorganization procedure afforded by Section 77 of the Bankruptcy Act, the covenant would be unenforceable as contrary to the Act and the public policy that the railroad shall be kept together for continued operation and its reorganization submitted to the Interstate Commerce Commission.

This case deals with the reorganization of a railroad. Section 77 relates only to railroads and its provisions reflect both the paramount public interest in the continued

operation of railroads and the special machinery provided in order to protect this public interest and to deal with the peculiar problems involved in so doing.

The objectives and the intentions of Congress in enacting Section 77 were discussed at some length in the opinion of this Court in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448 (1942). Mr. Justice REED, speaking for the Court, said (p. 468):

> "These reorganizations require something more than contests between adversary interests to produce plans which are fair and in the public interest. When the public interest, as distinguished from private, bulks large in the problem, the solution is largely a function of the legislative and administrative agencies of government with their facilities and experience in investigating all aspects of the problem and appraising the general interest. Congress outlined the course reorganization is to follow. It established standards for administration and placed in the hands of the Commission the primary responsibility for the development of a suitable plan. When examined to learn the purpose of its enactment, § 77 manifests the intention of Congress to place reorganization under the leadership of the Commission, subject to a degree of participation by the court.
>
> "It is clear from the discussions and the statute itself that there was recognition by everyone of the advantages of utilizing the facilities of the Commission for investigation into the many-sided problems of transportation service, finance and public interest involved in even minor railroad reorganizations and utilizing the Commission's experience in these fields for the appraisals of values and the development of a plan of reorganization, fair to the public, creditors and stockholders. The resulting legislation was an attempted balance between the power of the Commission and that of the court."

The opinion then reviews in considerable detail the legislative history of the statute. This discussion makes it clear that Congress was concerned above all that the interest of the public should be protected, that railroad operations should not be interrupted by the financial difficulties of the railroads or the enforcement of the rights of those having claims against them, and that to this end the Interstate Commerce Commission's informed experience was given a large place in the handling of each situation.

Since in the case of railroad reorganizations, the major purpose is the protection of the public interest in the continued operation of a railroad until the Commission shall determine that its services are not needed, one of the objectives of Section 77 is to hold the railroad's properties together for operation. This brings Section 77 into sharp contrast with other portions of the Bankruptcy Act where the claims of creditors are paramount and the purpose of the provisions is to achieve a marshalling of a debtor's assets for liquidation or other disposition for the protection of those having claims against the debtor.

Collier on Bankruptcy (14th Ed.), Vol 4, p. 468, says that Section 77

> "reflects a public policy that the operation of railroads as sound, economic units should be achieved for the benefit of the public, regardless of the interests of creditors and stockholders."

In *Continental Bank* v. *Rock Island Ry.*, 294 U. S. 648, the Court said at page 671:

> "Section 77 advances another step in the direction of liberalizing the law on the subject of bankruptcies. Railway corporations had been definitely excluded from the operation of the law in 1910 (c. 412, § 4, 36 Stat. 838, 839), probably because such corporations could not be liquidated in the ordinary

way or by a distribution of assets. A railway is a unit; it can not be divided up and disposed of piecemeal like a stock of goods. It must be sold, if sold at all, as a unit and as a going concern. Its activities can not be halted because its continuous, uninterrupted operation is necessary in the public interest; and, for the preservation of that interest, as well as for the protection of the various private interests involved, reorganization was evidently regarded as the most feasible solution whenever the corporation had become 'insolvent or unable to meet its debts as they mature.'"

This important purpose of Section 77 has been stressed by the courts in other cases. In *Van Schaick* v. *McCarthy*, 116 F. (2d) 987, (C. C. A. 10th, 1941) the Court said (p. 992):

> "Sec. 77 has for its main purpose the rehabilitation of the debtor by a readjustment of its financial structure in the interest of the debtor and its creditors and security holders, under a fair and equitable plan of reorganization which shall so modify or alter the rights of both secured and unsecured creditors that the fixed charges shall be brought within the probable future earnings available for the payment thereof. During the process of reorganization it contemplates the continued corporate existence of the debtor under the control and supervision of the court."

And in *In re Central of Georgia Ry. Co.*, 48 F. Supp. 445 (D. C., S. D. Georgia), aff'd in 135 F. (2d) 592 (C. C. A. Fifth), the Court emphasized that the purpose of Section 77 was to keep the railroad properties together until a plan of reorganization could be worked out. It said (p. 449):

> "To permit the steamship line to be divorced from the railway at this time is tantamount to a dismemberment of the system. If I properly under-

stand the philosophy of section 77 of the Bankruptcy Act as amended, 11 U. S. C. A. 205, under which these proceedings were taken, among other things, it was to prevent the disintegration of a railway by parceling out the mortgaged property in divisions or according to prior liens, and to preserve it as a unit of the national transportation system until reasonable opportunity has been furnished to develop and submit a plan of reorganization which will be fair and equitable to all of the interests concerned. If at the very time the trustee, his advisory committee, and the several bondholders' committees are attempting to develop such a plan they are met with the threat that the steamship company, regarded by many of them as an integral part of the system, is to be withdrawn and liquidated or operated independently of the railway, they will be denied what I consider a reasonable opportunity through negotiation to reorganize the system as a whole."

Section 77 evidences the intention of Congress, not only that the properties of a railroad shall be kept together for its continued operation, but also that the Commission shall have a major role in its reorganization in the interest of the public.

Thus by subdivision (o) it is provided that the Trustee may dispose of properties of a railroad or may be ordered by the Court so to do only

> "with the approval and authorization of the Commission when required by chapter 1 of Title 49 * * * ".

Even a line held under a lease which is rejected must be operated

> "until the abandonment of such line is authorized by the Commission * * * " [subd. (c) (6)].

And, most important, the main feature of Section 77 is its requirement [subd. (d)] that the debtor shall file a plan

of reorganization, that this shall then be considered by the Commission, and that the Commission

> "shall render a report and order in which it shall approve a plan * * *".

The decisions are full of expressions by the courts stressing the important part which Congress intends the Commission to play in railroad reorganization proceedings under Section 77.

Ecker v. *Western Pacific Corporation*, 318 U. S. 448;

Collier on Bankruptcy (14th ed.), Vol. 5, p. 469.

In *Palmer* v. *Massachusetts*, 308 U. S. 79 (1939), Mr. Justice FRANKFURTER, speaking for this Court, said (pp. 86-87):

> "But the long history of federal railroad receiverships, with the conflicts they frequently engendered between the federal courts and the public, left an enduring conviction that a railroad was not like an ordinary insolvent estate. Also an insolvent railroad, it was realized, required the oversight of agencies specially charged with the public interest represented by the transportation system. Indeed, when, in the depth of the depression, legislation was deemed urgent to meet the grave crisis confronting the railroads, there was a strong sentiment in Congress to withdraw from the courts control over insolvent railroads and lodge it with the Interstate Commerce Commission. Congress stopped short of this remedy. But the whole scheme of § 77 leaves no doubt that Congress did not mean to grant to the district courts the same scope as to bankrupt roads that they may have in dealing with other bankrupt estates."

It is obvious that these important purposes of Section 77 would be defeated if a covenant in a lease against transfer could be construed and enforced as working a forfeiture of the lease upon the qualification of a trustee in a reorganization proceeding or upon his adoption of a lease for the purpose of preserving the railroad as an entity pending the preparation and approval of a plan of reorganization.

It is well known that a large part of the railroad mileage of the country is held by the operating railroads under long term leases.* Congress must have contemplated that the objectives sought by Section 77 should not be defeated by permitting resort to the procedure provided by the statute to be the cause of forfeiture of such leases.

Hence we submit that even if the covenant of the lease here involved should be construed as including the qualification of a trustee in reorganization or his adoption of the lease as one of the causes of forfeiture provided for therein, the clause would be and is rendered unenforceable by reason of Section 77 itself. If the choice is between accomplishing the public purpose of the statute and carrying out its provisions on the one hand and giving full effect to the language of a lease on the other hand, the lease must yield. *Louisville & Nashville R. R.* v. *Mottley*, 219 U. S. 467.

It is recognized, of course, that in situations under other provisions of the Bankruptcy Act, effect has been given to forfeiture clauses in leases when such clauses have met the test that to be enforceable they must refer to bankruptcy and transfer by operation of law in specific terms. This is expressly provided for in Section 77B, and it is on this that the Court rested its decision in *Finn* v. *Meighan*, 65 S. Ct. 1147, cited by the Court below (R. 96). But in

* Healy, *The Economics of Railroad Transportation* (1940), at page 302 states that 28,524 miles of railroad, or 12 per cent of the total mileage operated in the United States, are operated under lease.

these situations the matter has concerned only the debtors and their creditors. The public has not been involved, as it is in the reorganization of a railroad.

Illustrative of this difference and of significance for the purposes of this case is the absence from Section 77 of the provision written into Section 110 (b), which constituted the basis of the decision in *King* v. *Meighan*, 65 S. Ct. 1147, that

> "an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same shall be enforceable."

The court below appears to have held that sub-paragraph (l) of Section 77 in some way makes Section 110 (b) applicable here. It is submitted, however, that this is incorrect.

Subdivision (l) provides:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Thus, although it is said that "the rights and liabilities of creditors * * * with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed", nevertheless the subdivision expressly provides that this is so only so far as "consistent with the provisions thereof" (Section 77). The forfeiture of a lease of an important part of a railroad's right of way

would certainly not be consistent with the purposes of Section 77 or with the provisions thereof, including the provision for a plan of reorganization and the provision that such a plan may provide for the adoption or rejection of unexpired leases.

POINT II.

Neither the filing of the petition for reorganization, the qualification of the Trustee nor the Trustee's adoption of the lease constituted a breach of the covenant against transfer.

It is well settled that provisions for forfeiture of leases are to be narrowly construed. They must be construed strictly, not only in accordance with their own language but also in the light of the provisions and purposes of applicable statutes. It has accordingly been held that a general covenant not to assign or transfer is not breached by a petition in bankruptcy so as to permit the landlord to assert a forfeiture. Only if the lease specifically and in express terms provides that it shall terminate upon bankruptcy is it held that bankruptcy works a forfeiture.

Gidlay v. *Williams*, 210 U. S. 41;
In re Prudential Lithograph Co. (D. C. N. Y.), 265 Fed. 869; aff'd 270 Fed. 469; cert. den. 256 U. S. 692;
In re Levinson, 295 Fed. 146 (D. C. W. D. Wash. N. D. 1923);
In re Gutman, 197 Fed. 472;
Collier on Bankruptcy (14th Ed.), Vol. 4, pp. 1240, 1241.

This principle, that effect will not be given to a forfeiture clause except in strict accordance with its express terms, narrowly construed, has especial force in a proceed-

ing such as this involving the reorganization of a railroad, where the public interest is concerned.

It is submitted that under this principle it cannot properly be held here that there has been a breach of the lease involved in this suit.

The lease does not specify "reorganization", "bankruptcy" or even "transfer by operation of law".

Looking at the covenant in the main-stem lease, Article Third, paragraph (1) (R. 64, 65), it is plain that neither the inauguration of the reorganization proceedings, the qualification of the Trustee nor the adoption of the lease by the Trustee violated the language of the first part of the paragraph, whereby it was provided that:

> "The Lessee shall not and will not sell, assign or transfer this lease or underlet the demised premises, * * *" (R. 64).

So far this is a typical covenant against assignment, and the cases previously cited are conclusive that such a clause does not afford a right to terminate upon bankruptcy, much less because of what is done in a reorganization proceeding.

The claim of the lessor and the decisions of the courts below rest, therefore, on the last sentence of the paragraph, that:

> "This covenant shall also apply to any unauthorized sale or transfer thereof or underletting of the demised premises, or any part thereof, * * * whether made by the Lessee or in any proceeding, whether at law or in equity or otherwise, to which the Lessee may be a party, whereby any of the rights, duties and obligations of the Lessee shall or may be transferred, encumbered, abrogated or in any manner altered, without the consent of the Lessor * * *" (R. 65).

It is submitted, however, that there has been no breach of this clause.

In the first place, what is meant by an "unauthorized" transfer? Certainly the procedure provided by statute to enable a railroad to continue in operation in the service of the public cannot be regarded as "unauthorized". Assuming for the moment that there was a "sale or transfer", to hold that it was "unauthorized" would mean that by the use of that term the parties intended to contract that the railroad operating over the leased property should be forever barred from resorting to any procedure which might thereafter be provided by statute fo the purpose of enabling it, in time of need, to reorganize its liabilities so that it should be able to continue to operate and to carry out the terms of the lease. Such a conclusion would place an unreasonable meaning on the word "unauthorized".

But it is submitted further that neither the filing of the petition, the qualification of the Trustee nor the Trustee's adoption of the lease, pursuant to the court's order, constituted a "sale or transfer * * * or underletting of the demised premises". Obviously none of these acts constituted a "sale" or an "underletting". Was any of them a "transfer" within the meaning of this language as properly interpreted? Not all transfers are barred by the covenant. It is only a transfer by which "the rights, duties, and obligations of the Lessee shall or may be transferred, encumbered, abrogated or in any manner altered" which is within the prohibition of the covenant. This makes it necessary to consider what really takes place when a trustee qualifies or when a lease of a railroad is adopted by a trustee in a reorganization proceeding.

A trustee in an ordinary bankruptcy proceeding takes the debtor's property for the purpose of liquidating it for the benefit of creditors. The expectation is that the assets will be sold and the bankrupt's title to and interest therein will be extinguished. This is plainly what was contem-

plated by the language of the lease involved here. But we submit that neither the qualification of the Trustee nor his adoption of the lease came within the intent of this language because the Trustee does not take the property to liquidate it.

In the reorganization of a railroad under Section 77, as we have shown under the previous point, the Trustee takes the property to conserve it for the debtor. Although the statute in subsection (c) (2) says that "The trustee * * * shall have all the title * * * of a trustee appointed pursuant to section 72", this is subject to the proviso that he may exercise his powers only "subject to the control of the judge and consistently with the provisions of this section." The trustee, by virtue of subdivision (o), may sell or abandon any part of the debtor's property or right of way only when he determines that this can be done "without unduly and adversely affecting the public interest.", and also only pursuant to an order of the judge after hearing on notice to parties in interest, and then only with the approval and authorization of the Interstate Commerce Commission when required by Section 1(18) of the Interstate Commerce Act, none of which conditions has been met here.

Except under the foregoing conditions the trustee may not sell the leasehold or any other asset, nor may the judge direct him to do so. The property may ultimately be disposed of only in accordance with a plan of reorganization approved by the Interstate Commerce Commission and then confirmed by the court. The only other exception to this is the right of a trustee to reject executory contracts.

Thus the trustee holds the debtor's property, not for the sake of disposing of it, but for the purpose of keeping it intact as a going railroad and of returning it to the debtor when a plan for reorganizing the debtor's obligations and capital structure has been worked out. In other words,

upon adoption of the lease and until a plan of reorganization becomes effective the trustee really holds the property for the debtor, he pays the debtor's obligations under the lease from the debtor's funds and, in effect, for the debtor's account. And unless the plan of reorganization provides for the rejection, as provided for under subsection (b) of Section 77, or modification of the lease, the debtor or lessee resumes all of its rights and obligations thereunder for itself.

In short, we submit that what transpires when a trustee in a railroad reorganization adopts a lease is not a transfer of the sort described by the covenant involved here, in that it does not permanently transfer nor does it of itself encumber, abrogate or alter the rights, duties and obligations of the lessee. It preserves them.

If a corporation worked out a reorganization of its capital structure by agreement among its security holders and continued to carry out the terms of any lease or executory contract which it might have, it could not be claimed that there was a transfer or assignment of a lease which would constitute a breach of a covenant against assignment. The tenancy would be uninterrupted. This is exactly the result here if a lease is adopted. The reorganization is carried on under the supervision of the court and the Interstate Commerce Commission instead of by voluntary agreement among the security holders and creditors, but it is nevertheless a reorganization and not a liquidation or distribution and transfer of assets. The trustee's function is to preserve the debtor's estate during the accomplishment of reorganization and carry out all of the terms of the lease on behalf of the debtor. When the plan of reorganization is worked out and the reorganization completed, if the plan provides for the adoption of the lease by the debtor there will, in effect, have been no interruption whatever in the debtor's occupancy of the premises and performance of

the terms of the lease. It is only if there were a sale or abandonment authorized by subdivision (o.) or if the lease should ultimately be rejected that there would be any transfer of the lease or leased premises from the debtor-lessee and the latter would be a transfer to the landlord.

Moreover, we submit that it cannot be said that the adoption of the lease by the Trustee was "without the consent of the Lessor", because the statute itself provides the consent. Any other view, as we have said previously, would mean that the parties by their lease in 1906 intended to contract that the debtor-lessee should never have the right to use legal machinery for reorganization to enable it to continue to fulfill the lease for the period of its term. We submit that such a view imposes an unreasonable sense upon simple words. Certainly it would not constitute a construction of the language of the forfeiture clause strictly against forfeiture as required by the cases previously cited.

It may be observed, also, that a contrary conclusion would produce the anomalous result that the lower court, by its own act in directing the Trustee to adopt the lease, would be the cause of a termination of the lease by the landlord, which would defeat the very adoption by the Trustee which the court directed. If this were the law the lower court should not have directed the adoption of the lease but should, as he had the right to do, have allowed the matter of rejection or adoption to await the submission of a plan of reorganization, in which event, in accordance with the authorities cited under the next point, all rights of the landlord under the lease would have been held in suspense.

Finally, on this point, we submit if of two possible interpretations of the language of the lease one will render the contract valid while the other will make it unenforceable and against public policy, the former is the one which must be adopted. As we have argued in the first point, if

the covenant here should be construed as giving the landlord the right to cancel the lease under the circumstances here, it would be contrary to public policy as disclosed by the enactment of Section 77 of the Bankruptcy Act and the Interstate Commerce Act.

POINT III.

In advance of a plan of reorganization the attempted cancellation of the lease and the courts' orders permitting such cancellation were premature.

This is, perhaps, merely a restatement of the first point. It is plain from the provisions of Section 77 that the intention of Congress was that railroad properties should be held together until a plan of reorganization should be evolved, filed and approved. The statute says that the plan shall be filed by the debtor; that the plan shall provide for either the adoption or the rejection of executory contracts or leases; and that the plan when filed shall then be considered by the Commission which, after hearing, "shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed". The plan and the Commission's consideration and report on it are the central features of the scheme of Section 77.

Hence, until a plan has been filed and considered, it is premature to permit any disposition to be made of the railroad's properties. To this there are only two exceptions, previously referred to, neither of which is applicable here. The first is the rejection of a lease or executory contract as burdensome to the debtor's estate. But even in case of such rejection, the operation of the railroad must be continued unless and until the Commission permits its abandonment [Subdivision (c) (6)]. *Warren* v. *Palmer*, 310 U. S. 132 (1940). The Trustee here has not rejected the lease, he has adopted it. The other exception is pro-

vided for by subdivision (6) which empowers the Trustee if he determines that a line or other property "should be abandoned or sold during the pendency of the proceedings in the interest of the debtor's estate and of ultimate reorganization" to sell or abandon such line or property. But here also the approval of the Commission is a prerequisite. The Trustee has made no such determination, nor could he do so. And the Commission has not approved or authorized the Trustee to part with the property covered by the Court's Order No. 39.

Hence we submit that since the plan of reorganization contemplated by Section 77 has not yet been filed, since it has not been determined whether the leases are compatible with such a plan, it is entirely premature to permit the debtor's property to be taken from the Trustee, thereby completely frustrating the plan and the carrying out of the provisions of Section 77. It must be the effect of Section 77, therefore, to hold everything in abeyance until a plan of reorganization is filed and approved. Otherwise Section 77 would be unworkable.

This will more clearly appear if the decisions of the District Court and of the Circuit Court of Appeals are considered separately.

A. The qualification of the Trustee did not entitle the lessor to cancel the lease because all rights under the contract were held in suspense by Section 77 and the reorganization proceeding thereunder.

As previously observed there is a strange inconsistency between the decision of the District Court as set out in Judge FAKE's opinion and the Circuit Court's ruling. Judge FAKE held (R. 44, 48) that it was the qualification of the

Trustee and his coming into theoretical possession of the property of the debtor-lessee which constituted the transfer which violated the covenant of the lease. This was what the lessor had alleged; it was on the basis of this that the lessor gave its notice of cancellation (R. 35). The Circuit Court of Appeals held, however, that it was the adoption of the lease by the Trustee which constituted the breach of the covenant (R. 96).

Considering only Judge FAKE's view of the matter, and disregarding the inconsistency in his own action in thereafter ordering the Trustee to adopt the lease (R. 38, 39) which on his theory had been cancelled, it is submitted that when the Trustee was appointed and qualified, the lease was in suspense by virtue of Section 77 so that it could not be violated, and the lessor's rights to enforce its provisions were likewise in suspense.

It is plainly the intent of the statute and it seems well settled that in a reorganization proceeding a reasonable period of time is allowed for the preparation and filing of a plan of reorganization which will provide either for the adoption or for the rejection of leases and other executory contracts, and that meanwhile breaches of such contracts may not be asserted or enforced in suits. An owner of leased property is, of course, entitled to just compensation for its use—but on a *quantum meruit* basis rather than by virtue of the terms of his lease.

The leading case on this point is *Palmer* v. *Palmer*, 104 F. (2d) 161 (C. C. A. 2nd, 1939); cert. den. 308 U. S. 590, where it was held that a lessor of property of a railroad in reorganization could not cancel a lease for breach of a covenant to pay rent. Judge LEARNED HAND, in writing the opinion of the Circuit Court of Appeals, said (p. 163):

> "A lease, being property *cum onere*, does not pass to a trustee in bankruptcy, unless he adopts it."

He remarked that if the question were to arise for the first time it might be difficult to see

> "by what power the court could keep a trustee in possession while he was determining his course, without compelling him meanwhile to fulfill the conditions imposed upon the term, for instance, the payment of any rent, secured by a right of reentry."

But he went on to say:

> "Nevertheless, the contrary has been generally held; and the trustee's adoption of the term is said to 'relate back' to the beginning of the proceeding, or at least to adjudication. The reason for this is not clear. It does not follow from § 70 of the Bankruptcy Act, 11 U. S. C. A. § 110, which vests the trustee's title only 'by operation of law'; for title to the term vests not by operation of law at all, but only by the trustee's adoption. Be that as it may, the trustee need not pay the rent during the probationary period, and the court will hold off the lessor, and force him to be content with the value of the use and occupation meanwhile, though ordinarily it will fix that at the same amount as the rent. This was the result in Quincy, etc., R. Co. v. Humphreys, 145 U. S. 82, 12 S. Ct. 787, 36 L. Ed. 632, and in United States Trust Co. v. Wabash Railway, 150 U. S. 287, 14 S. Ct. 86, 37 L. Ed. 1085, though so many other circumstances were thought relevant that we are not clear as to the precise scope of either ruling. But we have ourselves a number of times declared that the trustee's title 'relates back', or that he is liable only for use and occupation, and in some instances what we said was necessary to the result. In Re Frazin, supra, 183 F. 28, 32; In re Sherwoods, 2 Cir., 210 F. 754, Ann. Cas. 1916A, 940; Johnson v. Emerson Phonograph Co., 2 Cir., 296 F. 42, 45; Heineman Corp. v. Levy & Co., 2 Cir., 6 F. 2d 970, 975; In re United Cigar Stores Co., 2 Cir., 69 F. 2d 513, 515; Central Manhattan Properties v. D. A. Schulte, 2

Cir., 91 F. 2d 728, 730. Whether justified in principle or not, the doctrine has by now become too well fixed to be uprooted, especially since no change was made when the whole subject was overhauled in the Chandler Act."

The same principle was recognized by this Court in *Continental Bank* v. *Rock Island Ry.*, 294 U. S. 648, in which it was held that the District Court, acting under the provisions of Section 77, could delay by injunction the enforcement of a contract which empowered the Continental Bank and other lenders to sell collateral pledged as security for loans made to the debtor, on failure to pay interest, insolvency of the debtor or the appointment of a receiver for its properties. At pages 676 and 677 the Court said:

"The injunction does not infringe § 67 (d), U. S. C. Title 11, § 107 (d). The substance of that provision is that bona fide liens shall not be affected by anything contained in the Bankruptcy Act. The injunction here in no way impairs the lien, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action. It may be, as suggested, that during the period of restraint the collateral will decline in value; but the same may be said in respect of an injunction against the sale of real estate upon foreclosure of a mortgage; and such an injunction may issue in an ordinary proceeding in bankruptcy. *Straton* v. *New*, 283 U. S. 318, 321, and cases cited. A claim that injurious consequences will result to the pledgee or the mortgagee may not, of course, be disregarded by the district court; but it presents a question addressed not to the power of the court but to its discretion—a matter not subject to the interference of an appellate court unless such discretion be improvidently exercised. So far as constitutional power is concerned, there is no difference between an injunction restraining the enforcement of

> a real-estate mortgage and one restraining the enforcement of a pledge by the sale of collateral security. Such differences as exist affect not the power but the propriety of its exercise—that is to say, the discretion of the court. Such an injunction, as just indicated, is within the contemplation of § 77, and we need not inquire whether it would be admissible under the act in force prior to the adoption of that section. Compare *Straton* v. *New*, *supra*. Nor does § 57 (h), 11 U. S. C. § 93 (h), also invoked by petitioners, have any pertinent application to the question under discussion in the light of the provisions, purpose and aim of § 77."

See also *United States Trust Co.* v. *Wabash Rwy. Co.*, 150 U. S. 287, 299, 300.

In an illuminating article discussing at length various problems in connection with railroad reorganizations under Section 77, *Railroad Leases and Reorganization*, 49 Yale Law Journal 140, Professor Mack, citing the foregoing and other decisions, concludes (p. 1413) that for a trial period which

> "in modern reorganizations—will and should be somewhat longer than that accorded under old equity practice" (p. 1414)

during which a trustee may determine whether to adopt or reject a lease,

> "The court may prevent the Lessor from retaking its properties for this period without payment of any rent whatever" (p. 1413).

If the lessor may not cancel a lease and retake the property for breach of a covenant to pay rent, equally it may not do so for breach of a covenant against transfer.

B. The adoption of the lease by the Trustee in advance of a plan of reorganization did not entitle the lessor to cancel it for breach of the covenant against transfer.

We submit that the opinion of the Circuit Court of Appeals that

> "the lease was breached when it was adopted by the trustee" (R. 96)

is equally inconsistent and unsound. The purpose of keeping the property together and holding off creditors and lessors is to insure the continued operation of the railroad and make it possible to formulate and carry out a plan of reorganization. The Trustee here adopted the lease for that very purpose (R. 36). The court directed him to do so on his petition asserting that purpose (R. 38). It would be anomalous, to say the least, if the court by its order defeated the very purpose for which the order was made.

Subdivision (b) of Section 77 expressly states that a plan of reorganization

> "may reject contracts of the debtor which are executory in whole or in part, including unexpired leases."

And it provides further that:

> "The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder."

In other words, the Trustee's adoption is an interim affair. It does not bind or affect the plan. It is the plan which is finally to determine whether a lease is to be adopted and continued in force or is to be rejected. Hence, on the authority of the cases cited under the previous point, the effect of the statute must be to hold in suspense all leases

and the rights of lessors thereunder for final disposition in the reorganization plan.

In *Van Schaick* v. *McCarthy*, 116 F. (2d) 987 (C. C. A. Tenth), previously cited, the Court said:

> "Sec. 77 provides for the submission of the plan to the Interstate Commerce Commission, for a public hearing before the Commission, for a certification of the plan to the court, and for a hearing before the court. It further provides that if the judge does not approve the plan, he may refer it back to the Commission for further action. It is manifest that a considerable period of time must necessarily elapse before a satisfactory and proper plan can be worked out and receive the requisite approval. During that period the railroad company must be operated by the trustees under the supervision and control of the court in the public interest and for the protection of the private interests involved, and to that end such expenditures must be made as are reasonably necessary to preserve and protect those interests and maintain the integrity of the railroad, so that it may be turned over to the reorganized company as a going concern. Sec. 77 contemplates that the reorganized road shall be a living, not a dying, railroad enterprise."

POINT IV.

The order of the District Court permitting the lessor Connecting Company to cancel the main stem lease and directing the Trustee to convey to the Connecting Company not only the property covered by that lease but also all other railroad property used or operated by the debtor-lessee violated Section 77 of the Bankruptcy Act and Section 1 (18) of the Interstate Commerce Act and was contrary to the condition imposed by the Court in its opinion.

A. The Trustee could not lawfully transfer the property and abandon operation of the railroad in the absence of a certificate of convenience and necessity from the Interstate Commerce Commission authorizing it to do so.

The provisions of Section 77 of the Bankruptcy Act are tied into and have a common purpose with Section 1 (18) of the Interstate Commerce Act, to insure the continued operation of a railroad in the public interest by the carrier engaged in that operation until transfer of the railroad properties and abandonment of operations are authorized by the Interstate Commerce Commission.

Section 1 (18) of the Interstate Commerce Act provides, in part, that:

> "After ninety days after this paragraph takes effect * * * no carrier by railroad subject to this part shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment."

It goes without saying that the return of the main stem to the Connecting Company and the transfer to the Connecting Company of all the railroad property of the debtor-lessee, as required by the District Court's order, would mean an abandonment by the Trustee or the debtor-lessee of the operation of the railroad which the latter has operated since June 19, 1906.

The Commission has consistently held as an administrative interpretation of Section 1 (18) that a railroad operating leased property may not terminate its lease and discontinue operations without a certificate from the Commission. *Lehigh Valley R. Co. Abandonment of Operation*, 202 I. C. C. 659; *Norfolk S. R. Co. Receivers Abandonment*, 221 I. C. C. 258; *Duluth & I. R. R. Co. Control*, 224 I. C. C. 353.

It is submitted that this requirement of the Interstate Commerce Act, designed to insure continued operation of a railroad by a lessee, superseded and controls the provisions of the lease here involved, even assuming for the sake of argument that the qualification of the Trustee or his adoption of the lease would otherwise be a breach of the covenant against transfer.

Moreover, the provisions of Section 77 make it very clear that a Trustee may not convey or relinquish railroad property required for the operation of the railroad, nor may the court order him to do so, without the approval of the Interstate Commerce Commission, except only by rejecting an unexpired lease or executory contract. Even in the case of rejection of a lease, subdivision (c) (6) makes specific provision for the continued operation of a railroad "until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1." *Warren* v. *Palmer*, 310 U. S. 132 (1940). Of course the lease here has not been rejected but has been adopted by the Trustee.

The ultimate continuance or discontinuance of service is a matter for the Commission. *Webster & Atlas Nat. Bank of Boston v. Palmer*, 111 F. (2d) 215 (C. C. A. Conn.).

In *Palmer v. Massachusetts*, 308 U. S. 79, 87, 88, this Court said:

> "The judicial process in bankruptcy proceedings under § 77 is, as it were, brigaded with the administrative process of the Commission. From the requirement of ratification by the Commission of the trustees appointed by the court to the Commission's approval of the court's plan of reorganization the authority of the court is intertwined with that of the Commission. Thus, in § 77(c) and § 77(o) *the power of the district courts to permit abandonment is specifically conditioned on authorization of such abandonments by the Commission.*" (Italics ours.)

Here no authority in any form has been secured from the Commission by the Trustee or the debtor-lessee to discontinue the operation of the railroad or to relinquish possession of or transfer any of the railroad properties essential for such operation. Hence, we submit that the District Court could not lawfully make its Order No. 39 which would have that result.

B. The lessor Connecting Company may not lawfully acquire and operate as a railroad the properties to be conveyed to it pursuant to the District Court's order since it has not secured a certificate of convenience and necessity from the Interstate Commerce Commission authorizing it to do so.

Section 1 (18) of the Interstate Commerce Act also provides, in part, that ninety days after it takes effect

> "no carrier by railroad subject to this part * * * shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation under this part over or by means of such additional or extended line of railroad, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the * * * operation * * * of such additional or extended line of railroad, * * *."

This statute, which was enacted in 1920, in effect requires anyone who was not then operating a railroad to obtain a certificate from the Commission before acquiring and operating one. This has been held to apply to the acquisition by one party of a railroad already being operated by another. *Wyoming & M. R. Ry. Co. Application*, 79 I. C. C. 121; *Bonhomie & H. S. R. Co. Acquisition*, 90 I. C. C. 448; *Great Northern Pac. Ry. Co. Acquisition*, 162 I. C. C. 37.

The Connecting Company was not an operating railroad company when Section 1 (18) of the Interstate Commerce Act became law. It is submitted that it may not now lawfully acquire or operate a railroad without securing a certificate of convenience and necessity from the Commission. This it admittedly has not done.

It is true, of course, and the court below relied on the fact, that the Connecting Company had applied to the Commission for such a certificate and the Commission had dismissed its application upon a ruling that since it was the owner of the leased property and by termination of the lease was taking back property owned by it, it did not need a certificate to reacquire such property and operate it as a railroad. It is submitted that this decision of the Commission was erroneous as a matter of law and should not have been accepted by and does not excuse the action of the court below.

The reasoning of the Commission was, in effect, that the Connecting Company has really been operating the railroad all the time through the agency of its tenant. This is unsound. A tenant is in no sense an agent of its landlord but operates in its own right and by virtue of its lease has an estate in the property separate and distinct from that of the lessor.

Tiffany, Law of Real Property, 3rd Ed. Sections 76, 79, 99.

The Commission argued further that the Connecting Company was under a continuing obligation by reason of its franchise to operate the railroad properties and that, therefore, "No certificate from us is needed because the lessor's obligations and duties to the public have never ceased but have merely been performed by the lessee for its benefit" (R. 56-57). This is, again, the agency theory. It is contrary to the provisions of Section 1 (18) of the Interstate Commerce Act, which contains no such exception from its requirement of a certificate. In fact, it flies squarely in the face of both the language and the purpose of Section 1 (18)-(20), that in the matter of the acquisition, construction, operation or abandonment of a line of railroad in interstate commerce the jurisdiction of the Interstate Commerce Commission is supreme and exclusive and a franchise from a state gives no authority to operate without a certificate from the Commission.

R. R. Comm. v. *Southern Pac. Co.*, 264 U. S. 331;
Texas &c. R. R. v. *Northside Ry.*, 276 U. S. 475;
Transit Commission v. *United States*, 289 U. S. 121;
Long Island R. Co., Trackage, 162 I. C. C. 218;
Construction of Line by Jefferson Southwestern, 86 I. C. C. 796.

In the *Transit Commission* case, this Court upheld the decision of the Commission in the *Long Island Railroad* case cited, in which the Commission determined that the fact that the Long Island was to operate as lessee pursuant to a contract which had been approved by the state did not eliminate the necessity for a certificate from the Interstate Commerce Commission.

Moreover, the theory of the Commission's decision here is inconsistent with its own decisions, including those previously cited, wherein it has held that one seeking to acquire railroad property by lease and begin operation thereof as a railroad, as well as a railroad which has operated leased property and seeks to abandon operation upon termination of its lease must secure a certificate from the Commission before beginning or ceasing operation, as the case may be.

Livestock Terminal Service Co. Abandonment, 257 I. C. C. 1;
Duluth & I. R. R. Co. Control, 224 I. C. C. 353;
Norfolk S. R. Co. Receivers Abandonment, 221 I. C. C. 258;
Lehigh Valley R. Co. Abandonment of Operation, 202 I. C. C. 659.

In the *Livestock Terminal* and *Lehigh Valley* cases the Commission held that the fact that the lessor refused to renew the lease except on terms unacceptable to the lessee did not permit the lessee to abandon operation without having obtained a certificate from the Commission authorizing it to do so.

In the *Duluth* case, the Commission, at page 356, said:

> "the lessee may not lawfully abandon operation of the leased lines without first having obtained from us a certificate under section 1(18) of the act."

If a lessee may not begin operation of a railroad or abandon operation without a certificate from the Commission, it certainly cannot be said that the lessee is operating as agent for the lessor and in fulfillment of the lessor's rights and franchise obligations. At least this is so for the purpose of Section 1(18)-(20) of the Interstate Commerce Act.

Finally, the Commission's decision does not excuse the action of the lower court here, because the court's order turns over to the Connecting Company not only property owned by it, which, on the Commission's assumption it was under a franchise obligation to operate, but also property of the Hoboken Land and Improvement Company which, so far as appears from the record, the Connecting Company never operated or was under any obligation to operate, and property owned by the debtor-lessee the right to which is in dispute. As to these several portions of the property which would be delivered to the Connecting Company under the court's order, even the Commission's reasoning affords no escape from the requirement of a certificate from the Commission as a condition precedent to operation.

The District Court in its opinion conditioned the granting of the motion to terminate the lease "upon production to the court of conclusive evidence that the requirement of the laws relating to the continuous operation of the railroad have been complied with" (R. 45). It is submitted that this condition has not been fulfilled and that, therefore, the order is contrary to the District Court's own opinion.

POINT V.

Order No. 39 should be reversed because it transfers to the lessor possession of certain railroad property owned by the debtor-lessee before determination of conflicting claims thereto.

The order under review provides in part that:

> "3. Notwithstanding conflicting claims thereto, within the time and in the manner set forth in this order all property of the debtor in the possession or under the control of the trustee and presently held or used for railroad purposes, whether real, personal or mixed, excepting money in bank, cash on hand, accounts receivable, choses in action or other intangible claims, and the evidences thereof, shall be delivered to said Hoboken Railroad, Warehouse and Steamship Connecting Company by the trustee. The trustee, or any other claimant, may thereupon file a claim or claims with the Clerk of this court, after first serving a copy thereof upon said company or its attorneys, for recovery of such property or its value and reasonable compensation for the use thereof, which claims will thereupon be determined by this court through reference to a Master or otherwise." (R. 59).

The property of the debtor which the Trustee is directed to deliver to the Connecting Company includes land and tracks leading to the float bridge and a short portion at the end of the right of way with tracks and two sidings which are owned by the debtor. The Trustee and debtor maintain that these properties are not covered by the leases and that the Connecting Company has no right to them upon termination of the leases.

The Circuit Court of Appeals excuses this phase of the order on the ground that it is "a wise one for it permits the operation of this small trackage as part of the main

stem of the railroad" (R. 97). It is submitted, however, that until the submission of a plan of reorganization it was not within the authority of the court to dispose of property of the railroad merely because the court considered that such disposal would produce a desirable result from the standpoint of railroad operation. It is for the plan of reorganization to propose and the Commission to decide, subject to the ultimate approval of the court, what disposition of the properties of the railroad will conform to the requirements of Section 77 and the public interest. It is immaterial that the items of property in question were small. The railroad as a whole is a small railroad and tracks 265 feet in length and a track 20 feet in length, constituting the connecting link with a float bridge, which is its means of interchange with one of the principal trunk line railroads in New York harbor, are not insignificant in proportion to the railroad as a whole. They are as great, relatively, as would be many miles of track in relation to a transcontinental line.

Conclusion.

For the reasons set forth herein, it is submitted that Order No. 39 of the District Court was invalid; that the opinion of the District Court, upon which that order was based, and the opinion of the Circuit Court of Appeals affirming it were unsound and incorrect in law; and that the judgment below should be reversed and Order No. 39 should be cancelled and annulled.

Respectfully submitted,

PARKER MCCOLLESTER,
25 Broadway,
New York 4, N. Y.,

EDWARD A. MARKLEY,
1 Exchange Place,
Jersey City 3, N. J.,

Attorneys for Hoboken Manufacturers Railroad Company, Debtor, and Seatrain Lines, Inc., Petitioners.

Dated: December 3, 1945.

APPENDIX.

Controlling Statutes.

Section 77 of the Bankruptcy Act, U. S. C. Title 11, Section 205, 49 Stat. 911, is being printed in full in the brief for the Trustee and is therefore not reproduced here.

Interstate Commerce Act, U. S. C. Title 49, Section 1, 49 Stat. 543.

Section 1 (18) provides:

> "After ninety days after this paragraph takes effect no carrier by railroad subject to this part shall undertake the extension of its line of railroad, or the construction of a new line of railroad, or shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation under this part over or by means of such additional or extended line of railroad, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line of railroad, and no carrier by railroad subject to this part shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment. Nothing in this paragraph or in section 5 shall be considered to prohibit the making of contracts between carriers by railroad subject to this part, without the approval of the Commission, for the joint ownership or joint use of spur, industrial, team, switching, or side tracks."

Section 1 (20) provides:

> "The Commission shall have power to issue such certificate as prayed for, or to refuse to issue it, or to

issue it for a portion or portions of a line of railroad, or extension thereof, described in the application, or for the partial exercise only of such right or privilege, and may attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require. From and after issuance of such certificate, and not before, the carrier by railroad may, without securing approval other than such certificate, comply with the terms and conditions contained in or attached to the issuance of such certificate and proceed with the construction, operation, or abandonment covered thereby. Any construction, operation, or abandonment contrary to the provisions of this paragraph or of paragraph (18) or (19) of this section may be enjoined by any court of competent jurisdiction at the suit of the United States, the Commission, any commission or regulating body of the State or States affected, or any party in interest; and any carrier which, or any director, officer, receiver, operating trustee, lessee, agent, or person, acting for or employed by such carrier, who knowingly authorizes, consents to, or permits any violation of the provisions of this paragraph or of paragraph (18) of this section, shall upon conviction thereof be punished by a fine of not more than $5,000 or by imprisonment for not more than three years, or both."